BANK *of* NORTH DAKOTA

Annual Report

1919

1994

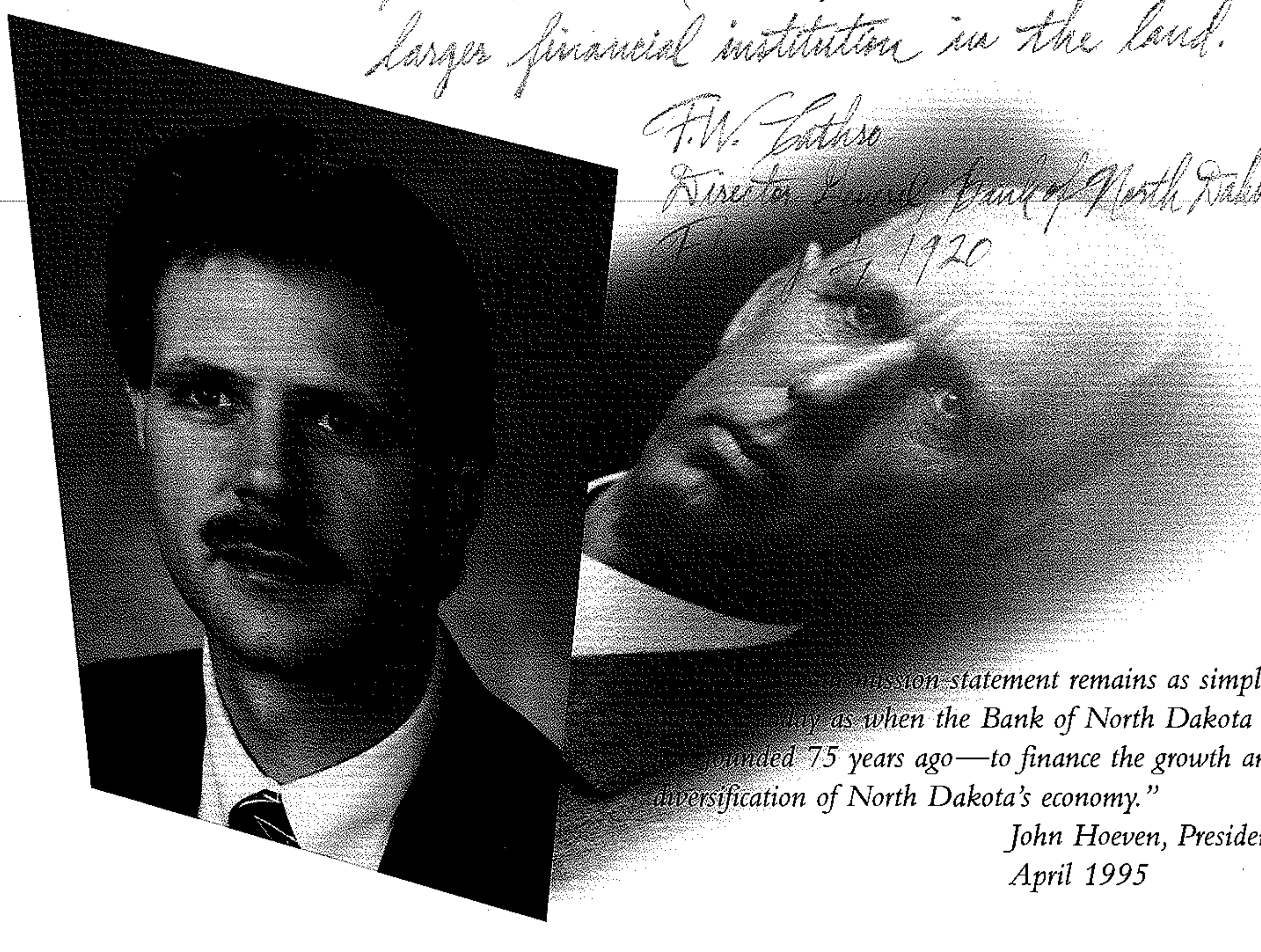
One simple vision stands the test of time and guides us into the future.

Presidents' Remarks

The people of North Dakota are industrious and progressive.

All the energies of the people, their faith and integrity, and all of their immense natural wealth are back of the Bank of North Dakota. The moral guarantee cannot be measured in dollars, but the tangible resources of the state alone, guaranteeing deposits in the Bank of North Dakota, may be conservatively estimated at $6 million. With the exception of the Federal Reserve System there will be no larger financial institution in the land.

F.W. Cathro
Director General Bank of North Dakota
1920



"Our mission statement remains as simple today as when the Bank of North Dakota was founded 75 years ago—to finance the growth and diversification of North Dakota's economy."

John Hoeven, President
April 1995

This 75th Anniversary Annual Report reflects both BND's proud heritage and its focus on the future. During 1994, management and staff—with input from the Advisory Board and the Industrial Commission—worked to redefine the Bank's Strategic Plan. BND is a unique institution combining elements of banking and state government with a primary role in financing economic development. The Bank was founded in 1919, "... to promote agriculture, commerce, and industry in North Dakota." This language, taken from the statute which created the Bank of North Dakota, forms the core of our mission statement: "... to deliver quality, sound financial services to promote the development of agriculture, commerce, and industry in North Dakota, and provide financial assistance to individuals to further post-secondary educational opportunities."

The Bank's Strategic Plan includes four major categories of objectives, and 1994 proved to be very successful for BND based on significant accomplishments in each one of these categories.

OBJECTIVE #1: *Play a lead role in financing the expansion and diversification of the state's economy and its job base.*

BND increased its loan portfolio by over $100 million in 1994, excluding residential loans held for resale. Commercial loan volume led the way increasing from $78 million to $120 million, a gain of 54%. Farm loan volumes also increased dramatically by $20 million—or 24%—over the prior year. Student loans held by the Bank increased $47 million. On a net basis, however, total student loans owned or administered by the Bank increased $26 million or 10% due to repayments received by the Student Loan Trust.

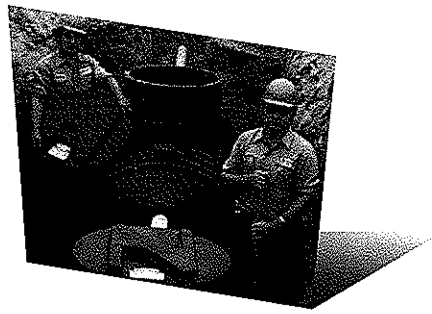
During the course of 1993 and 1994, BND doubled its loan portfolio to almost $400 million. The Bank is a participation lender; the vast majority of its loans are made in tandem with financial institutions throughout the state. This $200 million increase in our portfolio, combined with the private financial institutions participation in these loans has injected well over $300 million into North Dakota's economy for farming enterprises, business expansion, housing, and funding for students to attend school.

Demand for PACE Program loans continued strong. PACE loans funded or committed totaled $70 million with over 3,000 jobs already in place or committed to be in place within one year. Each of the 175 PACE loans represents creation of a new business or expansion of an existing business generating additional employment. Among BND's farm loan programs the demand for Beginning Farmer loans also continued to be very strong. BND has made or committed almost 700 Beginning Farmer loans, each one representing the first-time purchase of farmland by a beginning farmer. The delinquency and default performance for both PACE and the Beginning Farmer programs has been very favorable, and both programs exemplify BND's approach to financing economic development and job creation.

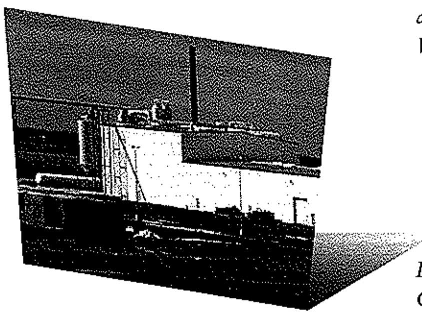
On the page opposite are seven of nearly 250 business and industrial projects BND helped fund in 1994.

BND's commitment to financing the expansion and diversification of North Dakota's economy is also demonstrated in the number of projects funded. BND worked closely with local financial institutions and with other funding sources to manage risk properly and provide the best financial package for the customer. Funding for some projects exceeded $15 million and included as many as eight to ten funding sources.

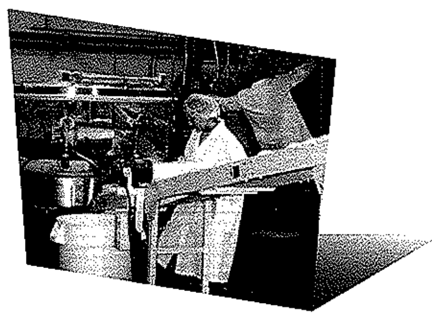
F.S.P., INC., a manufacturer of rotational molding equipment which has just constructed a new plant in Walhalla



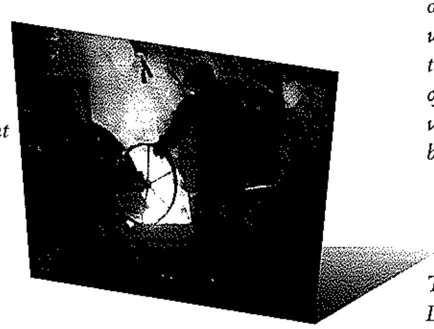
PRIMEBOARD INC., a new plant in Wahpeton, which will produce particle board from wheat straw



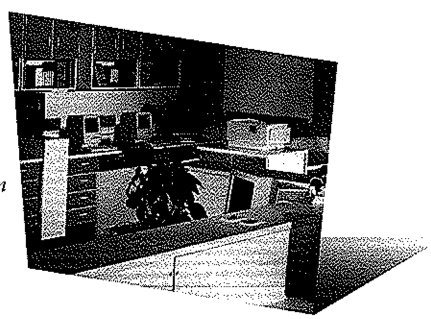
DRAYTON GRAIN PROCESSORS, a cooperative organized to add value to agriculture through processing of wheat into a variety of frozen bakery products



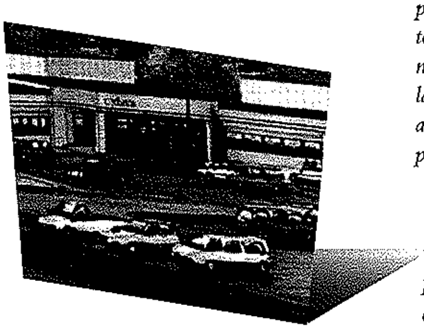
INTEGRA CASTINGS, U.S.A., INC., a metal casting plant being constructed in Cando, which will cast metal products for industrial and agricultural use



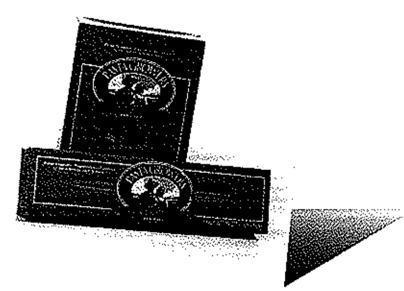
TMI SYSTEMS DESIGN CORP., a manufacturing company that provides solutions to storage and design needs with modular laminate casework and woodwork products



UNISYS, an accounting and data processing center in Bismarck, which will employ up to 280 people



DAKOTA GROWERS PASTA COMPANY, a new plant in Carrington that mills 10,000 bushels of North Dakota durum into 400,000 pounds of pasta daily



O B J E C T I V E # 2 : *Generate a consistent financial return to the State of North Dakota with income growth over time.*

The Bank's strong loan growth also spurred an increase in earnings for 1994. Earnings for the year totaled $18,031,000 exceeding BND's budgeted income by over $3.5 million. Based on the dramatic increase in interest rates anticipated for 1994, management had projected lower earings for BND. In fact, interest rates increased more dramatically than expected; however, restructuring of the Bank's balance sheet, which was undertaken early in 1993, combined with the growth in loan volumes more than offset the negative impact of rising interest rates. As a result, BND realized an outstanding return on equity of 18% and a return on assets of 1.93%.

Even more important, BND is structured to maintain its earnings with growth over time. Several years ago, BND faced a decline in future income due to major challenges. These challenges included a 20% reduction in the Bank's equity; a negatively gapped balance sheet that left the Bank vulnerable to rising interest rates; a $24 million deficit in the North Dakota Real Estate Trust which needed to be funded; and significant cost involved in converting 250,000 student loans to a new software system. Comprehensive plans were put in place to deal with these issues, but earnings were projected to slide for at least two years. Instead, through the outstanding efforts of all of our employees, BND has increased its income for 1994 and positioned the Bank to increase income in future years. These bottom-line results reflect the quality of work produced by our employees.

O B J E C T I V E # 3 : *Maintain and protect the capital strength and financial integrity of the Bank in accordance with the Bank's capital plan.*

As BND finances economic development and works to increase earnings, the underlying financial strength and integrity of its balance sheet must be carefully maintained. In 1994, BND sought—and for the first time received—a national credit rating. Standard and Poors assigned an A1+ short-term, AA- long-term rating. This rating is among the highest in the country for financial institutions and will help the Bank reduce its overall cost of doing business by reducing the cost of its purchased funds. BND also obtained approval from the Federal Home Loan Bank to borrow term funds thereby helping to better hedge the balance sheet against interest rate risk.

The growth in BND's loan portfolio has been carefully managed to protect against undue credit or default risk. BND loan officers, loan committees, and credit review personnel utilize sound underwriting criteria, but the Bank employs other important credit risk management techniques as well. Local financial institutions are generally required to take substantial portions of loans participated to BND. This practice insures that loans meet the underwriting criteria of private sector banks and that credit risk is shared between BND and lead banks. In addition, BND utilizes the federal guarantee agencies whenever possible, including SBA, FmHA, and BIA. The Bank's loan portfolio has grown to exceed $400 million, but almost $200 million is guaranteed through various federal programs.

These risk management practices and a generally good economy helped reduce net charge-offs to $50,000 for 1994, the lowest level in over 15 years. With its significantly larger portfolio, BND does anticipate more loan charge-offs in future years, and up to 1% of total unguaranteed loans is an acceptable range. To protect against future loan losses, BND added approximately $2.5 million to its loan loss reserves for the year, increasing the Bank's loan loss reserve to 3.9% of total loans and 7.8% of unguaranteed loans—very high ratios relative to industry averages.

O B J E C T I V E # 4 : *Develop a proactive, goal-oriented, learning culture to ensure continuous superior customer service and total quality management.*

Accomplishment of all BND's goals and objectives rests on the Bank's continued commitment to train its people and upgrade its technological resources. Improvements in the Student Loan Division typify this commitment.

In 1993, due to changes in the federal student loan program, BND faced the need to completely reorganize its student loan operations and upgrade to new data processing systems. These changes created significant challenges for our employees and increased cost of operations. As student loan and data processing personnel adapted to the new systems, performance has improved and costs have been reduced, even with increased student loan volume.

An audit of student loan operations in 1994 by Deloitte Touche, a national audit firm, and an on-site test of BND's data systems by the Department of Education provided high marks. The DOE test scheduled to take three days was completed in one-half day and found BND fully in compliance with the new requirements. Deloitte Touche awarded BND a Category 1 ranking, their highest rating for loan servicing. Furthermore, with implementation of planned improvements to the software systems, BND projects a decrease in data processing costs for 1995.

Other divisions of the Bank have implemented cost efficiencies and improvements in customer service through training and technology as well. The Retail and Operations Division has increased check processing volumes 24% over the last two years without adding personnel. BND now process 150,000 items per day for 120 financial institutions. The Investment and Trust Division worked diligently to put the Bank's credit rating in place and spearheaded improvements in BND's asset-liability practices. Lending staff continued to upgrade their skills, not only to better deliver BND's programs but also to take a lead in developing integrated financial packages using other federal, state, and local financing programs. For the second year in a row, the North Dakota Bankers Association's survey of its member banks rated BND highly in delivering financing programs for economic development.

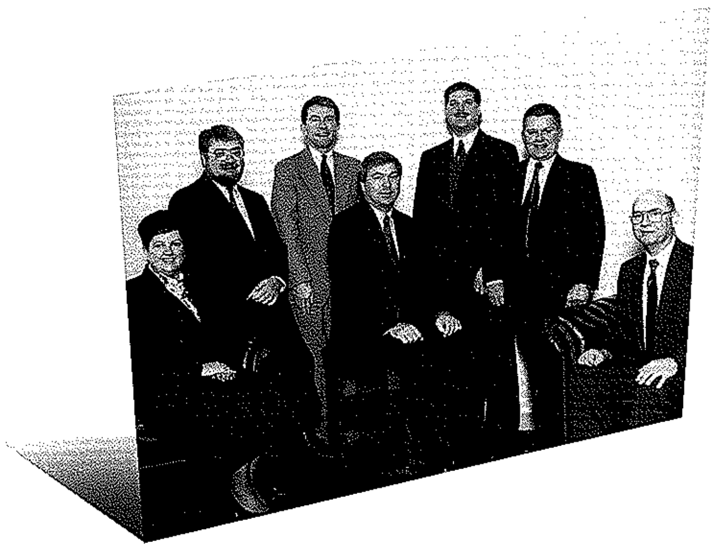
S U M M A R Y

In summary, the State's Vision 2000 process undertaken in the late 1980s reaffirmed North Dakota's need for a development bank to finance expansion and diversification of our economy. Throughout the organization, BND employees demonstrated their commitment to our strategic vision:

> *To be the development bank of North Dakota, responsible for financing economic growth while maintaining strong partnerships and a sound financial base with consistent earnings.*

BND must maintain a strong capital base and continue to develop sound programs that help manage risk and provide incentive financing. In the process, the Bank will continue to generate substantial earnings for the state's general fund, but the *real benefit* from BND's fulfillment of its role as the development bank of North Dakota is *expansion of the state's economic base and employment opportunities for its citizens.*

North Dakota Industrial Commission: Commissioner of Agriculture Sarah Vogel; Governor Ed Schafer, Chairman; and Attorney General Heidi Heitkamp



BND's Advisory Board: Maren Daley, Don Porter, Frank Keogh, Curly Haugland, Todd Lang, Roger Berglund, and Bill Kingsbury

BND's Executive Committee: Ed Sather, Kathy Ibach, Julie Kubisiak, John Hoeven, Bob Gruman, and Dale Eberle

INDEPENDENT AUDITOR'S REPORT

The Industrial Commission
State of North Dakota
Bismarck, North Dakota

We have audited the accompanying balance sheets of The Bank of North Dakota as of December 31, 1994 and 1993, and the related statements of income, changes in capital funds and cash flows for the years then ended. These financial statements are the responsibility of the Bank's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance abour whether the financial statements are free of material misstarement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of The Bank of North Dakota as of December 31, 1994 and 1993, and the results of its operations and its cash flows for the years then ended in conformity with generally accepted accounting principles.

BRADY, MARTZ & ASSOCIATES, P.C.

January 20, 1995
Minot, North Dakota

THE BANK OF NORTH DAKOTA

BALANCE SHEETS

DECEMBER 31, 1994 AND 1993

ASSETS

	1994 (in thousands)	1993 (in thousands)
CASH AND DUE FROM BANKS	$ 99,715	$ 77,163
FEDERAL FUNDS SOLD AND SECURITIES PURCHASED UNDER AGREEMENTS TO RESELL	79,810	62,680
CASH AND CASH EQUIVALENTS	179,525	139,843
SECURITIES AVAILABLE FOR SALE	37,364	-
SECURITIES HELD TO MATURITY	323,827	428,333
Less allowance for investment losses	(2,792)	(3,792)
	358,399	424,541
LOANS HELD FOR SALE	203	14,996
LOANS	391,142	290,556
Less allowance for loan losses	(15,348)	(12,900)
	375,997	292,652
BANK PREMISES, EQUIPMENT AND SOFTWARE	3,775	4,205
ACCRUED INTEREST RECEIVABLE	11,152	8,557
OTHER ASSETS	3,811	2,422
TOTAL ASSETS	$ 932,659	$ 872,220

LIABILITIES AND CAPITAL FUNDS

	1994	1993
DEPOSITS:		
Non-interest bearing	$ 98,337	$ 87,916
Interest bearing	489,500	485,401
	587,837	573,317
FEDERAL FUNDS PURCHASED AND SECURITIES SOLD UNDER AGREEMENTS TO REPURCHASE	155,527	121,112
LONG-TERM DEBT	53,455	49,908
OTHER LIABILITIES	35,634	27,883
TOTAL LIABILITIES	832,453	772,220
CAPITAL FUNDS:		
Capital	22,000	22,000
Capital surplus	22,000	22,000
Contributed capital	1,394	1,394
Unrealized gain on securities available for sale	206	-
Undivided profits	54,606	54,606
Total capital funds	100,206	100,000
TOTAL LIABILITIES AND CAPITAL FUNDS	$ 932,659	$ 872,220

THE ACCOMPANYING NOTES ARE AN INTEGRAL PART OF THESE FINANCIAL STATEMENTS

THE BANK OF NORTH DAKOTA
STATEMENTS OF INCOME
FOR THE YEARS ENDED DECEMBER 31, 1994 AND 1993

	(in thousands) 1994	1993
INTEREST INCOME		
Interest on federal funds sold and securities purchased under agreements to resell	$ 4,035	$ 3,101
Interest on investment securities	20,471	24,879
Interest and fees on loans	26,858	18,853
	51,364	46,833
INTEREST EXPENSE		
Interest on deposits	16,773	14,542
Interest on federal funds purchased and securities sold under agreements to repurchase	7,535	4,694
Interest on long-term debt	4,256	4,220
	28,564	23,456
Net interest income	22,800	23,377
PROVISION FOR LOAN LOSSES	2,500	600
Net interest income after provision for loan losses	20,300	22,777
OTHER INCOME		
Service fees and other	7,437	6,636
Securities gains and losses	87	952
(Provision) recovery for investment losses	1,000	(2,200)
	8,524	5,388
OTHER EXPENSE		
Salaries	4,155	4,034
Pensions and other employee benefits	1,229	1,149
Data processing	2,499	2,199
Other operating expenses	2,229	2,514
Depreciation and amortization	681	739
	10,793	10,635
NET INCOME	$ 18,031	$ 17,530

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THE ACCOMPANYING NOTES ARE AN INTEGRAL PART OF THESE FINANCIAL STATEMENTS

THE BANK OF NORTH DAKOTA

STATEMENTS OF CHANGES IN CAPITAL FUNDS

FOR THE YEARS ENDED DECEMBER 31, 1994 AND 1993

(in thousands)

	Capital	Capital Surplus	Contributed Capital
BALANCES, JANUARY 1, 1993	$ 22,000	$ 22,000	$ 1,394
Net income	–	–	–
Appropriations	–	–	–
BALANCES, DECEMBER 31, 1993	$ 22,000	$ 22,000	$ 1,394
Net income	–	–	–
Appropriations	–	–	–
Change in net unrealized gain on securities available for sale	–	–	–
BALANCES, DECEMBER 31, 1994	$ 22,000	$ 22,000	$ 1,394

STATEMENTS OF CHANGES IN CAPITAL FUNDS *(Continued)*

(in thousands)

Unrealized Gain on Securities Available For Sale	Undivided Profits	Total
$ –	$ 68,725	$ 114,119
–	17,530	17,530
–	(31,649)	(31,649)
$ –	$ 54,606	$ 100,000
–	18,031	18,031
–	(18,031)	(18,031)
206	–	206
$ 206	$ 54,606	$ 100,206

THE ACCOMPANYING NOTES ARE AN INTEGRAL PART OF THESE FINANCIAL STATEMENTS

THE BANK OF NORTH DAKOTA

STATEMENTS OF CASH FLOWS

FOR THE YEARS ENDED DECEMBER 31, 1994 AND 1993

	(in thousands) 1994	1993
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	$ 18,031	$ 17,530
Adjustments to reconcile net income to net cash provided (used) by operating activities:		
Depreciation and amortization	791	847
Provision for loan losses	2,500	600
Provision for investment losses	(1,000)	2,200
Amortization of premiums and accretion of discounts on investment securities	64	(2)
Investment securities gains, net	(156)	(863)
Changes in assets and liabilities:		
(Increase) decrease in loans held for sale	14,793	(14,996)
(Increase) decrease in accrued interest receivable	(2,595)	2,705
Increase in other assets	(1,370)	(669)
Decrease in other liabilities	(10,280)	(10,231)
Net cash provided (used) by operating activities	$ 20,778	$ (2,879)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Securities available for sale transactions:		
Proceeds from sales, maturities and principal repayments	$ 158,197	$ -
Securities held to maturity transactions:		
Proceeds from sales, maturities and principal repayments	233,331	435,968
Purchase of securities	(324,088)	(405,022)
Net (increase) decrease in loans	(100,720)	22,898
Purchases of equipment and software	(251)	(676)
Net cash provided (used) by investing activities	$ (33,531)	$ 53,168
CASH FLOWS FROM FINANCING ACTIVITIES:		
Net increase (decrease) in non-interest bearing deposits	$ 10,421	$ (3,242)
Net increase in interest bearing deposits	4,099	5,204
Net increase (decrease) in federal funds purchased and securities sold under repurchase agreements	34,415	(201,196)
Proceeds from issuance of long-term debt	3,500	-
Net cash provided (used) in financing activities	$ 52,435	$ (199,234)
INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	$ 39,682	$ (148,945)
CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR	139,843	288,788
CASH AND CASH EQUIVALENTS, END OF YEAR	$ 179,525	$ 139,843
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:		
Cash payments for:		
Interest paid to customers	$ 16,773	$ 14,225
Interest paid on federal funds purchased and securities sold under repurchase agreements	7,545	4,710
Interest paid on long-term debt	3,971	3,938
SUPPLEMENTAL SCHEDULE OF NONCASH INVESTING AND FINANCING ACTIVITIES:		
Other real estate acquired in settlement of loans	$ 82	$ 55
Transfer from undivided profits to other liabilities	18,031	31,649
Unrealized gains on securities available for sale	206	-

THE ACCOMPANYING NOTES ARE AN INTEGRAL PART OF THESE FINANCIAL STATEMENTS

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The Bank of North Dakota is owned and operated by the State of North Dakota under the supervision of the Industrial Commission as provided by Chapter 6-09 of the North Dakota Century Code.

Statement of cash flows - The Bank considers currency on hand, demand deposits in other financial institutions, cash items expected to be converted to cash and federal funds sold and securities purchased under reverse repurchase agreements with original maturities of three months or less as cash and cash equivalents. The carrying amount of cash and cash equivalents is a reasonable estimate of its fair value.

Securities - Effective, January 1, 1994, the Bank adopted the provisions of Statement of Financial Accounting Standards (SFAS) No. 115, *Accounting for Certain Investments in Debt and Equity Securities*. SFAS 115 requires that investments in debt and equity securities be classified into three categories which then establishes the accounting requirements.

> **Trading securities** - Debt and equity securities that are bought and held principally for the purpose of selling them in the near term are classified as trading account securities and are reported at fair value. Gains and losses on sales of trading account securities and adjustments to fair values are included in securities gains and losses.
>
> **Securities available for sale** - Securities that are not trading securities and which may be sold before maturity in response to changes in interest rates or prepayment risk, or due to liquidity needs or changes in funding sources or terms, are classified as securities available for sale. These securities are carried at fair value, with unrealized holding gains and losses, reported in capital. When securities are sold, the amortized cost of the specific securities sold is used to compute the gain or loss on sale.
>
> **Securities held to maturity** - Securities which management has the positive intent and ability to hold to maturity. These securities are stated at cost, adjusted for amortization of premiums and accretion of discounts, which are recognized by adjustments to interest income. The allowance for investment losses is established through a provision for investment losses charged to expense and is attributable to specific adverse conditions for particular securities.

Loans held for sale - Mortgage loans purchased and held for sale in the secondary market are carried at the lower of cost or market value determined on an aggregate basis. Net unrealized losses are recognized in a valuation allowance through charges to income. Gains and losses on the sale of loans held for sale are determined using the specific identification method.

Loans - Loans are stated at the principal balance outstanding less an allowance for loan losses. Interest income on loans is accrued at the specific rate on the outstanding principal balance.

Interest accruals on loans are discontinued when in management's opinion the collection of the interest is doubtful. When a loan is placed on non-accrual status, accrued but uncollected interest is reversed. Interest accrued during the current year is reversed against current income, and interest accrued from prior years is charged against the allowance for loan losses.

Allowance for loan losses - The Bank uses the allowance method in providing for loan losses. Accordingly, the allowance is increased by the current years provision for loan losses charged to operations and reduced by net charge-offs.

The adequacy of the allowance for loan losses and the provisions for loan losses charged to operations are based on management's evaluation of a number of factors, including recent loan loss experience, continuous evaluation of the loan portfolio quality, current and anticipated economic conditions, and other pertinent factors. Loans are charged to the allowance when management believes the collection of the principal is doubtful.

Bank premises, equipment and software - Bank premises, equipment and software are stated at cost less accumulated depreciation or amortization. Depreciation and amortization are provided over the estimated useful lives of the individual assets using the straight-line method. The estimated useful lives used in the computation of depreciation or amortization are 25 years for bank premises, 5 years for equipment and software and 10 years for furniture.

Other real estate - Other real estate (ORE), which is included in other assets, represents properties acquired through foreclosure or other proceedings. ORE is recorded at the lower of the amount of the loan or fair market value of the properties. Any writedown to fair market value at the time of transfer to ORE is charged to the allowance for loan losses. Property is evaluated regularly to ensure that the recorded amount is supported by the current fair market value.

Long-term debt issue costs - Long-term debt issue costs are being amortized over the term of the related long-term debt using the straight-line method.

Defined benefit plan - The Bank funds amounts equal to pension costs accrued.

Income taxes - The Bank of North Dakota is a governmental agency of the State of North Dakota and as such is not obligated for federal or state income taxes.

Reclassification - Certain amounts in the 1993 financial statements have been reclassified to conform with the 1994 presentation. 13

NOTE 2 FEDERAL FUNDS SOLD AND SECURITIES PURCHASED UNDER AGREEMENTS TO RESELL

The breakdown of federal funds sold and securities purchased under agreements to resell are as follows:

	(in thousands) 1994	1993
Federal funds sold	$ 71,560	$ 62,680
Securities purchased under agreements to resell	8,250	-
	$ 79,810	$ 62,680

Federal funds sold generally mature the day following the date of sale.

The Bank enters into securities purchased under agreements to resell the same securities. These agreements may have a fixed maturity or be open-ended, callable at any time. The agreements are secured by Fed book-entry securities.

NOTE 3 **DEBT AND EQUITY SECURITIES**

Debt and equity securities have been classified in the financial statements according to management's intent. The carrying amount of securities and their approximate fair values at December 31 were as follows:

(in thousands)

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
SECURITIES AVAILABLE FOR SALE				
DECEMBER 31, 1994				
U.S. Treasury securities	$ 35,001	$ 103	$ 29	$ 35,075
Mortgage-backed securities	2,157	132	-	2,289
	$ 37,158	$ 235	$ 29	$ 37,364
SECURITIES HELD TO MATURITY				
DECEMBER 31, 1994				
U.S. Treasury securities	$ 161,777	$ -	$ 4,134	$ 157,643
Obligations to other U.S. government agencies	14,518	46	562	14,002
Mortgage-backed securities	126,066	-	3,747	122,319
Obligations of states and political subdivisions	14,777	-	-	14,777
Other securities	6,689	-	6,087	602
	$ 323,827	$ 46	$ 14,530	$ 309,343
SECURITIES HELD TO MATURITY				
DECEMBER 31, 1993				
U.S. Treasury securities	$ 254,792	$ 2,482	$ -	$ 257,274
Obligations to other U.S. government agencies	10,019	495	6	10,508
Mortgage-backed securities	126,532	466	404	126,594
Obligations of states and political subdivisions	12,989	-	502	12,487
Commercial paper	17,312	5	-	17,317
Other securities	6,689	-	6,587	102
	$ 428,333	$ 3,448	$ 7,499	$ 424,282

The scheduled maturities of securities held to maturity and securities available for sale at December 31, 1994 are as follows:

(in thousands)

	Securities Held To Maturity		Securities Available For Sale	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Due in one year or less	$ 38,048	$ 37,707	$ 35,001	$ 35,075
Due from one year to five years	141,027	136,718	-	-
Due from five to ten years	13,184	12,938	-	-
Due after ten years	131,568	121,980	2,157	2,289
	$ 323,827	$ 309,343	$ 37,158	$ 37,364

The scheduled maturities of securities held to maturity and securities available for sale at December 31, 1993 are as follows:

(in thousands)

	Securities Held To Maturity		Securities Available For Sale	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Due in one year or less	$ 99,303	$ 100,043	$ -	$ -
Due from one year to five years	185,669	187,904	-	-
Due from five to ten years	13,182	13,089	-	-
Due after ten years	130,179	123,246	-	-
	$ 428,333	$ 424,282	$ -	$ -

Mortgage-backed securities are classified according to their contractual maturity without consideration of contractual repayment or projected prepayments. The average weighted average life of the mortgage-backed securities is eight years.

Proceeds from sales of securities available for sale for the year ended December 31, 1994 is $110,097,000. Gross gains of $204,000 were realized on sales and gross losses of $48,000 were realized on sales in 1994. Proceeds from sales of investments in debt securities for the year December 31, 1993 was $55,884,000 and gross gains of $863,000 were realized on those sales.

Securities carried at $127,051,000 at December 31, 1994 and $39,044,000 at December 31, 1993 were used for securities sold under agreements to repurchase and for other required pledged purposes.The approximate market value of the securities at December 31, 1994 and 1993 was $124,721,000 and $39,967,000, respectively.

The detail of changes in the allowance for investment losses for the years ended December 31, 1994 and 1993 is as follows:

(in thousands)

	1994	1993
Balance, beginning of year	$ 3,792	$ 1,592
Provision (recovery) for investment losses	(1,000)	2,200
Balance, end of year	$ 2,792	$ 3,792

NOTE 4 **LOANS**

The composition of the loan portfolio at December 31, 1994 and 1993 is as follows:

(in thousands))

	1994	1993
Residential loans	$ 32,913	$ 42,322
Guaranteed student loans	122,714	75,026
Bank participation loans -		
Commercial	120,918	78,697
Agricultural	67,189	52,567
Farm real estate loans	30,026	25,638
State institutions	10,459	12,264
Bank stock	6,780	3,204
Other	143	838
	391,142	290,556
Less allowance for loan losses	15,348	12,900
	$ 375,794	$ 277,656

Nonaccrual and restructured loans amounted to $1,398,000 and $6,521,000, respectively, at December 31, 1994, and $919,000 and $7,645,000, respectively, at December 31, 1993. Additional interest income that would have been earned under original terms of the nonaccrual loans amounted to approximately $55,000 and $69,000 for 1994 and 1993, respectively.

The detail of changes in the allowance for loan losses for years ended December 31, 1994 and 1993 is as follows:

	(in thousands) 1994	1993
Balance, beginning of year	$ 12,900	$ 12,664
Provision charged to operations	2,500	600
Loans charged off	(305)	(534)
Recoveries	253	170
Balance, end of year	$ 15,348	$ 12,900

NOTE 5 **BANK PREMISES, EQUIPMENT AND SOFTWARE**

The following is a summary of changes in bank premises, equipment, furniture and software at December 31, 1994 and 1993:

(in thousands)

	Balance January 1, 1994	Additions	Retirements	Balance December 31, 1994
Land	$ 287	$ -	$ -	$ 287
Building	3,859	94	-	3,953
Equipment	2,103	63	-	2,166
Furniture	692	17	-	709
Software	1,808	77	-	1,885
	8,749	251	-	9,000
Less accumulated depreciation	4,544	681	-	5,225
	$ 4,205	$ (430)	$ -	$ 3,775

	Balance January 1, 1993	Additions	Retirements	Balance December 31, 1993
Land	$ 287	$ -	$ -	$ 287
Building	3,687	172	-	3,859
Equipment	1,867	236	-	2,103
Furniture	562	130	-	692
Software	1,670	138	-	1,808
	8,073	676	-	8,749
Less accumulated depreciation	3,805	739	-	4,544
	$ 4,268	$ (63)	$ -	$ 4,205

Depreciation and amortization expense on the above assets amounted to $681,000 and $739,000 in 1994 and 1993, respectively.

NOTE 6 FEDERAL FUNDS PURCHASED AND SECURITIES SOLD UNDER AGREEMENTS TO REPURCHASE

The breakdown of federal funds purchased and securities sold under agreements to repurchase are as follows:

	(in thousands) 1994	1993
Federal funds purchased	$ 80,288	$ 116,662
Securities sold under agreements to repurchase	75,239	4,450
	$ 155,527	$ 121,112

Federal funds purchased generally mature the day following the date of purchase.

The Bank enters into securities sold under agreements to repurchase the same securities. These agreements may have a fixed maturity or be open-ended, callable at any time. These agreements are secured by Fed book-entry securities. The market value of these securities at December 31, 1994 and 1993 was $75,351,000 and $4,454,000, respectively.

NOTE 7 LONG-TERM DEBT

Long-term debt consists of:

	(in thousands) 1994	1993
Long-term notes, 7.875%, (effective interest rate 7.94%) issued December 1986, due December 1996	$ 50,000	$ 50,000
Less unamortized discount	45	92
	49,955	49,908
Federal Home Loan Bank advances	3,500	-
	$ 53,455	$ 49,908

A summary, by years, of future minimum payments required to amortize the outstanding debt is as follows:

	Principal	(in thousands) Interest	Total
1995	$ -	$ 4,220	$ 4,220
1996	50,000	4,057	54,057
1997	-	283	283
1998	-	283	283
1999	3,500	250	3,750
Total	$ 53,500	$ 9,093	$ 62,593

These notes may not he redeemed prior to maturity. Interest is payable semiannually on June 15 and December 15 of each year. The Bank of North Dakota entered into a letter of credit agreement dated December 1, 1986 with the Fuji Bank, Ltd. whereby the Fuji Bank has agreed to provide funds sufficient to pay the principal amount of the notes and up to 198 days' interest on the notes. Simultaneously with the letter of credit agreement, The Bank of North Dakota entered into a security agreement in which The Bank of North Dakota agreed to pledge eligible collateral. The notes are collateralized by government securities and FHA and VA guaranteed loans with balances of approximately $60,646,000 and $53,887,000 as of December 31, 1994 and 1993, respectively. The Bank is required to maintain an amount of eligible collateral such that the applicable value of the collateral is not less than 102.5% of the stated amount of the Fuji Bank letter of credit. The indenture of trust contains certain restrictive covenants, all of which the Bank is in compliance with as of December 31, 1994 and 1993, respectively.

Federal Home Loan Bank advances are secured by mortgage-backed securities with a carrying value of approximately $4,665,000 at December 31, 1994.

NOTE 8 OTHER LIABILITIES

Other liabilities consist of:

	(in thousands) 1994	1993
Appropriations payable	$ 29,664	$ 21,669
Interest	1,922	1,752
Student loan origination fee payable	1,183	646
Official checks	481	202
Accrued expenses	806	726
Other	1,578	2,888
	$ 35,634	$ 27,883

Appropriations have been transferred out of undivided profits to appropriations payable. The Industrial Commission is authorized during the biennium ending June 30, 1995, to transfer to the State General Fund $20,000,000 of accumulated and undivided profits, plus all earnings occurring during the biennium not to exceed $28,000,000. No transfers may be made which would reduce the Bank's capital structure below $100,000,000.

NOTE 9 DEFINED BENEFIT PLAN

All eligible employees of The Bank of North Dakota participate in the North Dakota Public Employees Retirement System ("System"), multiple-employer public employee retirement system. The payroll for Bank employees covered by the System for the years ended December 31, 1994 and 1993 was approximately $4,078,000 and $3,902,000, respectively. The Bank's total payroll was approximately $4,155,000 and $4,034,000, respectively.

All permanent employees as defined in chapter 54-52 of the North Dakota Century Code are eligible to participate in the System. Employees are entitled to unreduced pension benefits beginning when the sum of age and years of credited service equals 88, or at normal retirement age (65), equal to 1.74% of their final average annual salary for each year of service. Benefits fully vest at age 65 or on reaching five years of service. The System permits early retirement at ages 55-64, with five or more years of service. The System also provides death and disability benefits. Benefits are established by state statute.

State statute requires that 4% of each participating employees' gross wage be contributed to the plan by either the employee or by the employer under a "salary reduction" agreement. The same statute requires the Bank to contribute 4.12% of the employees wages. Administrative expenses and prior service costs are funded through the employer contributions. The contribution requirement for the years ended December 31, 1994 and 1993 was approximately $331,000 and $317,000, respectively.

The pension benefit obligation, which is the actuarial present value of credited projected benefits, is a standardized disclosure measure of the present value of pension benefits, adjusted for the effects of projected salary increases and any step-rate benefits, estimated to be payable in the future as a result of employee service to date. The measure is intended to help users assess the System's funding status on a going-concern basis, assess progress made in accumulating sufficient assets to pay benefits when due, and make comparisons among public employee retirement systems and employers. The System does not make separate measurements of assets and pension benefit obligations for individual employers. The pension benefit obligation at June 30, 1994 and 1993, for the System as a whole, was $450.6 million and $413.2 million, respectively. The System's net assets available for benefits (valued at market) on June 30, 1994 were $540.3 million and on June 30, 1993 were $528.0 million, leaving an over funded pension benefit obligation of $89.6 million and $114.8 million, respectively. The Bank's contribution represents approximately 1% of total contributions required of all participating entities.

Historical trend information showing the System's progress in accumulating sufficient assets to pay benefits when due, current measurements of the pension benefit obligation, and net assets available for benefits are presented in the System's June 30, 1994 and 1993 audited financial statements.

NOTE 10 **POST-RETIREMENT BENEFITS**

In addition to providing pension benefits, the state allows all PERS retirees to participate in the State Group Health Plan after retirement. The Bank's contribution requirement for the years ended December 31, 1994 and 1993, was approximately $41,000 and $39,000, respectively.

NOTE 11 **COMMITMENTS AND CONTINGENT LIABILITIES**

State of North Dakota long-term bonds - The State of North Dakota, through the North Dakota Real Estate Trust (Trust), issued long-term bonds in 1982, 1984 and 1986, of which the proceeds were used to provide funds to The Bank of North Dakota. In connection with these bond issues, The Bank of North Dakota is obligated to purchase bonds and uncertificated obligations when there is insufficient cash flow in the Trust for payment of the bonds and interest as they become due. It is probable that The Bank of North Dakota will be required to make further purchases of these bonds and uncertificated obligations. An estimate of the amount cannot be made because of the inability to predict cash flows in the Trust. The Bank of North Dakota holds bonds and uncertificated obligations with a carrying value of $3,295,000 at December 31, 1994 and 1993, respectively.

NOTE 12 **RELATED PARTY TRANSACTIONS**

The Bank, because of its unique relationship with the State of North Dakota, is a party in many business transactions with other entities of state government. All state funds, and funds of all state penal, education, and industrial institutions must be deposited in the Bank under state law. These transactions are a normal part of bank business and, accordingly, are included in the Bank's financial statements.

NOTE 13 **FINANCIAL INSTRUMENTS WITH OFF-BALANCE-SHEET RISK**

The Bank is a party to financial instruments with off-balance-sheet risk in the normal course of business. These financial instruments include commitments to extend credit, financial standby letters of credit, put and call agreements, and a guarantee agreement. Those instruments involve varying degrees of credit and interest rate risk in excess of the amount recognized in the balance sheet. The contract amounts of those instruments reflect the extent of involvement the Bank has in particular classes of off-balance-sheet financial instruments.

The Bank's exposure to credit loss in the event of nonperformance by the other party to the financial instrument for commitments to extend credit, financial standby letters of credit, and the guarantee agreement is represented by the contractual amount of those instruments. The Bank uses the same credit policies in making commitments and conditional obligations as it does for on-balance-sheet instruments. For the put and call agreements the actual risk of loss is less than the contract amount.

	Contract Amount (in thousands)	
	1994	1993
Financial standby letters of credit	$ 21,904	$ 24,381
Commitments to extend credit	78,952	63,285
Put and call agreements	890	890
Guarantee agreement	-	3,330
	$ 101,746	$ 91,886

Commitments to extend credit are agreements to lend as long as there is not violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The Bank evaluates each customer's credit worthiness on a case-by-case basis. The amount of collateral obtained by the Bank upon extension of credit is based on management's credit evaluation of the customer. Collateral held may include accounts receivable, inventory, property, plant and equipment, and income-producing commercial properties. Funding expectations for commercial and agricultural loan commitments vary. The fair value of these loans is not expected to have a material impact on the financial position of the Bank.

Financial standby letters of credit are conditional commitments issued by the Bank to guarantee the performance of a customer to a third party. Those guarantees are primarily issued to support public borrowing arrangements. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers. The likelihood of funding any of these letters of credit is considered to be remote. The fair value calculation is, therefore, limited to the cash flows associated with fee revenues over the life of the individual instruments. At December 31, 1994 and 1993, the fair value of those fee revenues is estimated to be $1,029,000 and $1,154,000, respectively.

The put and call agreements are contracts which allow the purchaser to exercise an option to sell the securities at a specified price back to the Bank upon specific circumstances and the Bank has a call option to purchase the securities from the customer at a specified future date at a specified price. Risk arises from the possible movements in the value of the securities. The Bank considers the likelihood of its having to fund this agreement to be remote. The fair value of the agreement is considered to be immaterial.

The guaranty agreement unconditionally guarantees that The Bank of North Dakota will make payments due for principal and interest owing on revenue bonds issued by a state agency. This guaranty expires upon the earlier to occur of (a) payment in full of all principal and interest due or to become due on the bonds or (b) the close of business on September 1, 1994. The Bank considers the likelihood of its having to fund this agreement to be remote. The fair value of the agreement is considered to be immaterial.

NOTE 14 SIGNIFICANT CONCENTRATIONS OF CREDIT RISK

Most of the Bank's business is with customers within the state of North Dakota. Concentrations of credit are present in the agricultural industry. Due to the pervasive nature of agriculture in the economy of the state, all loans, regardless of type, are impacted by agriculture. Loans for agricultural purposes comprised approximately 25% and 27% of the total loans at December 31, 1994 and 1993, respectively.

NOTE 15 FAIR VALUE OF FINANCIAL INSTRUMENTS

Statement of Financial Accounting Standards No. 107, Disclosures About Fair Value of Financial Instruments (FAS 107) requires the disclosures of estimated fair values of all asset, liability and off-balance sheet financial instruments. Fair value estimates under FAS 107 are determined as of a specific point in time utilizing various assumptions and estimates. Quoted market prices are the preferred means of estimating the value of a specific instrument, but in the cases where market quotes are not available, fair values are determined using various valuation techniques such as discounted cash flow calculations or by using pricing models.

Cash and cash equivalents - The carrying value of cash and cash equivalents approximates fair value due to the relatively short period of time between the origination of the instruments and their expected realization.

Securities available for sale and securities held to maturity - The fair value of securities were estimated using quoted market values, when available. If quoted market prices were not available, fair value was estimated using quoted market prices for similar assets.

Loans held for sale - Fair values of loans held for sale are stated at quoted market prices.

Residential loans - The fair value of residential loans has been estimated using a valuation technique which adjusts mortgages to approximate the quoted market yield for GNMA mortgage backed securities.

Guaranteed student loans - The fair value of student loans is based on quoted market prices.

The fair value of all other categories of loans has been estimated by discounting future cash flows to reflect management's estimate of current rates for financing borrowers under substantially similar terms and degrees of risk.

Accrued interest receivable and payable - The carrying value of interest receivable and payable approximates fair value due to the relatively short period of time between accrual and expected realization.

Deposits - In accordance with FAS 107, the fair value of deposits with no stated maturity, such as demand deposits, savings, NOW, and money market accounts, are disclosed as the amount payable on demand.

The fair value of interest bearing certificates of deposit has been estimated by discounting future cash flows using rates currently offered for deposits of similar remaining maturities.

Federal funds purchased and securities sold under agreements to repurchase - The carrying value of short term borrowings approximates fair value due to the relatively short period of time between the origination of the instruments and their expected payments.

Long-term debt - Quoted market prices were used to estimate the fair value of the long-term notes. Discounted cash flow analysis using current market rates of similar maturity debt was used to estimate the fair value of the Federal Home Loan Bank advances.

Other liabilities - The carrying value of other liabilities approximates fair value due to the short period of time until expected payment.

The carrying values and estimated fair values of the Bank's financial instruments at December 31, 1994 and 1993 were as follows:

(in thousands)

	1994		1993	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Financial Assets:				
Cash and cash equivalents	$ 179,525	$ 179,525	$ 139,843	$ 139,843
Securities available for sale	37,364	37,364	-	-
Securities held to maturity	323,827	309,343	428,333	424,282
Loans held for sale	203	203	14,996	14,996
Residential loans	32,913	31,099	42,322	45,292
Guaranteed student loans	122,714	122,959	75,026	75,401
Other loans	235,515	210,391	173,208	157,862
Accrued interest receivable	11,152	11,152	8,557	8,557
Financial Liabilities:				
Non-maturity deposits	306,725	306,725	290,987	290,987
Deposits with stated maturities	281,112	287,230	282,330	288,928
Federal funds pnrchased and securities sold under agreements to repurchase	155,527	155,527	121,112	121,112
Long-term debt	53,455	53,156	49,908	53,815
Other liabilities	35,634	35,634	27,883	27,883

OPERATING RESULTS (in thousands)	1994	1993	1992
Interest income	$ 51,364	$ 46,833	$ 57,107
Interest expense	28,564	23,456	28,251
Net interest income	22,800	23,377	28,856
Provision for loan losses	2,500	600	667
Net interest income after provision for loan losses	20,300	22,777	28,189
Other income	8,524	5,388	5,113
Other expenses	10,793	10,635	10,962
Net income	18,031	17,530	22,340
Paid to State Treasurer (Appropriation)	-	11,116	18,596
BALANCE SHEET - YEAR END (in thousands)			
TOTAL ASSETS	932,659	872,220	1,064,109
FEDERAL FUNDS SOLD AND SECURITIES PURCHASED UNDER REVERSE REPURCHASE AGREEMENTS	79,810	62,680	208,951
SECURITIES AVAILABLE FOR SALE	37,364	-	-
INVESTMENT SECURITIES	323,827	428,333	458,414
U.S. Treasury securities	161,777	254,792	316,861
Obligations of other U.S. Government agencies	14,518	10,019	10,030
Mortgage-backed securities	126,066	126,532	63,205
Other money market instruments			-
Obligations of states and political subdivisions	14,777	12,989	11,628
Commercial paper	-	17,312	50,000
Other securities	6,689	6,689	6,690
LOANS	391,345	305,552	313,873
Loans held for sale	203	14,996	-
Residential loans	32,913	42,322	61,655
Guaranteed student loans	122,714	75,026	118,639
Bank participation loans –			
Commercial	120,918	78,697	63,722
Agriculture	67,189	52,567	43,270
Farm real estate loans	30,026	25,638	20,675
State institutions	10,459	12,264	2,965
Bank Stock	6,780	3,204	2,795
Other loans	143	838	152
DEPOSITS -	587,837	573,317	571,355
Non-interest bearing	98,337	87,916	91,158
Interest bearing	489,500	485,401	480,197
FEDERAL FUNDS PURCHASED AND SECURITIES SOLD UNDER REPURCHASE AGREEMENTS	155,527	121,112	322,308
CAPITAL FUNDS	100,206	100,000	114,119
Capital	22,000	22,000	22,000
Surplus	22,000	22,000	22,000
Contributed capital	1,394	1,394	1,394
Unrealized Gain on securities available for sale	206	-	-
Undivided profits	54,606	54,606	68,725

SUMMARY

	1991	1990	1989	1988	1987	1986	1985
	$ 64,211	$ 69,783	$ 74,899	$ 68,884	$ 68,639	$ 75,948	$ 75,946
	41,391	52,727	55,990	49,489	48,221	52,680	55,765
	22,820	17,056	18,909	19,395	20,418	23,268	20,181
	698	–	–	750	2,000	10,153	6,893
	22,122	17,056	18,909	18,645	18,418	13,115	13,288
	5,083	4,631	4,485	3,684	3,484	3,908	3,704
	10,791	9,140	8,217	7,089	5,985	7,026	4,657
	16,414	12,547	15,176	15,240	15,917	9,997	12,335
	4,696	14,000	–	6,000	7,750	3,500	3,000
	956,759	893,972	971,866	900,113	884,569	944,592	980,348
	110,305	170,200	388,172	278,875	198,715	301,575	255,530
	–	–	–	–	–	–	–
	496,789	411,664	319,773	368,499	419,323	345,245	390,914
	349,028	230,117	86,228	252,057	270,218	267,828	300,934
	55,352	40,484	83,065	48,430	129,658	67,638	66,400
	72,925	75,574	–	–	–	–	–
	5,000	50,002	136,250	56,978	–	2,577	3,228
	7,942	7,381	5,927	4,971	14,450	6,987	20,352
	–	–	–	–	–	–	–
	6,542	8,106	8,303	6,063	4,997	215	–
	266,854	227,984	203,315	209,225	207,147	213,674	243,233
	–	–	–	–	–	–	–
	78,564	88,969	99,049	109,445	117,562	128,627	144,344
	86,487	46,886	32,744	29,373	21,204	23,745	21,336
	51,269	43,474	32,405	30,077	34,437	43,000	62,252
	28,636	22,786	15,495	12,489	13,172	4,753	–
	15,729	12,449	10,004	7,745	6,932	5,773	4,941
	3,167	8,441	8,590	13,856	3,102	1,443	1,665
	2,698	3,892	4,398	5,975	7,093	5,671	6,478
	304	1,087	631	265	3,645	662	2,217
	541,835	509,433	545,868	457,485	559,895	571,545	628,871
	80,789	60,794	49,133	48,947	68,563	82,885	122,722
	461,046	448,639	496,735	408,538	491,332	488,600	506,149
	247,664	227,955	255,952	274,434	162,500	217,877	246,585
	92,917	96,618	84,016	89,472	74,232	68,921	58,924
	22,000	22,000	22,000	22,000	22,000	22,000	21,750
	22,000	22,000	22,000	22,000	22,000	22,000	21,750
	1,394	1,394	1,394	1,394	1,394	–	–
	–	–	–	–	–	–	–
	47,523	51,224	38,622	44,078	28,838	24,921	15,424

"The Bank of North Dakota generates tremendous revenue for the State of North Dakota, but providing revenue is not the real reason for its existence. The state of North Dakota should not be in the business of banking simply for profit any more than it should be in any other type of business in competition with private enterprise. BND provides programs that work in harmony with private financial institutions to manage risk and reduce costs to borrowers. In this way, the Bank insures that North Dakotans have access to credit on a basis that will enable them to expand and diversify our economic base. The mission ...to promote agriculture, commerce, and industry in North Dakota is the real reason for the Bank of North Dakota's existence."

–John Hoeven, President